

Fiduciary Focus: The Pension Consultant Shell Game (Part 2)

W. Scott Simon | 11-07-05 |

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The article I wrote last month concerning the shell game played by many 401(k) plan pension consultants touched a real nerve among some readers, both pro and con. That article generated the most email I have received since I began writing this column nearly two years ago. Most writers agreed fervently with what I said in the article. But, boy oh boy, there were those that did not agree. Here is one such writer:

"I think [your] article was long on cynicism and short on practicality with a holier than thou attitude. [You] seemed to lump all pension consultants in the same boat in a rather irresponsible way. Maybe we should all just refer to WebMD and perform our own medical diagnosis and treatment plans. It would be a lot cheaper."

Is that the best you can do? Bring it on:

"I am sure that [you] can point to some RIAs that provide the types of services [you describe] to qualified plans in an inappropriate and conflicted manner. The problem with [your] article is that it implies that all business is done that way. The truth is that services similar to the ones described by [you] are provided to clients in an independent objective manner for a fair fee by many RIAs. You would never know that from [your] article. As a representative of all those who provide the kinds of services described by [you] in an objective and transparent way, I must tell you that I resent the implications of the article."

Okay, okay, I'm now starting to weaken from these thrashings. Mercifully, the following writer was a bit gentler in his criticism--although he still took me to the woodshed:

"While I generally liked your article on pension consultants, I thought you were a little too harsh on the industry. While there are certainly some poorly qualified consultants that overcharge clients for service, there are many who charge fairly and add significant value. The true value of a good consultant comes from industry expertise that cannot be replicated with a Morningstar.com subscription. To put the issue into perspective, we often find that we can help clients navigate the maze of revenue sharing and share classes such that net savings on fund costs are greater than our consulting fee, before considering any other value we may add--style drift, fund overlap, investment education, investment policy, etc."

Please let me set the record straight. I think that a careful and impartial reading of last month's article shows clearly that I never said that "all," nor even "most," pension plan consultants are corrupt--just "many" of them. In fact, I was gentler in my assessment than the staff report issued by the U.S. Securities and Exchange Commission. Indeed, that report found that "most" (not merely "many," as I stated) of the pension plan consultants studied--large, small, and middling--have rampant and corrupting conflicts of interest and that disclosure of same was usually non-existent.

Those of you (and you know who you are) who, whether registered investment advisors or otherwise, truly exhibit fiduciary conduct in your pension plan consulting work with no conflicts of interest are contributing to the greater good of our industry. I apologize heartily for any offense that I may have caused you as a result of last month's article. I certainly never meant to lump you in with the rest.

On the other hand, those of you (and you know who you are) who have conflicts of interest in your pension consulting work and fail to disclose them in a manner understandable to the very clients that you owe a fiduciary duty to are simply enablers in a cesspool of corruption. When you engage in such conduct, you are robbing real flesh-and-blood people of their retirement savings.

Those of you who are truly working for the greater good may want to consider creating a handout based on the Department of Labor/SEC fact sheet "Selecting and Monitoring Pension Consultants: Tips for Plan Fiduciaries" when marketing to plan sponsors. It will help differentiate yourselves from the many pension plan consultants who have helped contribute to the corruption of much of the pension consulting industry with their imprudent conduct.

For each question, I provide sample answers, which can be used by a registered investment advisory firm that is independent of a broker-dealer. You can bet that plan sponsors will start asking the questions in this fact sheet and assessing your answers to them.

Sample Handout

The Employee Retirement Income Security Act requires that trustees and other fiduciaries of employee benefit plans such as 401(k) plans administer and manage their plans prudently and in the sole interest of the plan's participants and their beneficiaries for the exclusive purpose of providing them with retirement benefits. In carrying out these responsibilities, fiduciaries of 401(k) plans such as yours must often turn to investment professionals such as [name of your firm] for help.

To encourage the disclosure and review of more and better information about potential conflicts of interest that investment professionals may have, the U.S. Department of Labor and the U.S. Securities and Exchange Commission have developed the following set of questions to assist trustees and other fiduciaries of 401(k) plans in evaluating the objectivity of the recommendations provided, or to be provided, by the investment professionals that advise them. [Name of your firm] provides the following answers to these questions to help the fiduciaries of your plan understand that we have no allegiance to any entity except our client, the [name of plan sponsor] 401(k) retirement plan.

1. Are you registered with the SEC or a state securities regulator as an investment adviser? If so, have you provided me with all the disclosures required under those laws (including Part II of Form ADV)?

[Name of your firm] is a registered investment advisor regulated by [your state's securities regulator or the SEC]. [our firm's ADV here](#). Enter "[name of your firm]" in the Firm Name box and click Go.

2. Do you or a related company have relationships with money managers that you recommend, consider for recommendation, or otherwise mention to the plan? If so, describe those relationships.

[Name of your firm] is an independent investment advisory firm with no material conflicts of interest. This means that we have no alliances or financial or other relationships with any outside money management firms, mutual fund companies, broker-dealer firms, or

insurance companies. Because we remain independent from any outside parties, we can retain complete objectivity in rendering advice to you.

3. Do you or a related company receive any payments from money managers you recommend, consider for recommendation, or otherwise mention to the plan for our consideration? If so, what is the extent of these payments in relation to your other income (revenue)?

[Name of your firm] does not receive payments from outside money management firms or any other third parties, thereby ensuring that we have no material conflicts of interest. This also ensures that we don't even have any potential conflicts of interest because we receive 100% of our compensation directly from our client, the [name of plan sponsor] 401(k) retirement plan.

4. Do you have any policies or procedures to address conflicts of interest or to prevent these payments or relationships from being a factor when you provide advice to your clients?

This question is not applicable to [name of your firm] because we do not receive payments from any outside third parties. 100% of the compensation that we receive comes from fees collected directly from our client, the [name of plan sponsor] 401(k) retirement plan.

5. If you allow plans to pay your consulting fees using the plan's brokerage commissions, do you monitor the amount of commissions paid and alert plans when consulting fees have been paid in full? If not, how can a plan make sure it does not over-pay its consulting fees?

This question is not applicable to [name of your firm] because we do not accept any commissions.

6. If you allow plans to pay your consulting fees using the plan's brokerage commissions, what steps do you take to ensure that the plan receives best execution for its securities trades?

This question is not applicable to [name of your firm] because we do not accept any commissions.

7. Do you have any arrangements with broker-dealers under which you or a related company will benefit if money managers place trades for their clients with such broker-dealers?

[Name of your firm] does not have any relationships with broker-dealers. Nor do we have any related companies. As a result, we have no current, or potential, conflicts of interest with any broker-dealer or related company.

8. If you are hired, will you acknowledge in writing that you have a fiduciary obligation as an investment advisor to the plan while providing the consulting services we are seeking?

In performing services under our agreement with [name of plan sponsor], [name of your firm] acts in a fiduciary capacity only to the extent provided by the Employee Retirement Income Security Act (ERISA) of 1974 and other applicable law.

Author's note: If you really want to walk on the wild side, you may want to delete the immediately preceding language under this question and substitute the following answer:

[Name of your firm] acknowledges its fiduciary obligations to all the retirement plans it advises. This acknowledgment is provided in writing through execution of an Investment Advisory Agreement that acknowledges our status as an ERISA-defined "investment manager" in accordance with ERISA section 3(38) and as an "independent fiduciary" in accordance with ERISA section 405(d)(1). Our acknowledgment makes [the name of your firm] solely responsible for the selection and monitoring of the investments options offered by your 401(k) plan.

9. Do you consider yourself a fiduciary under ERISA with respect to the recommendations you provide the plan?

[Name of your firm] is an ERISA-defined fiduciary as described in the immediately preceding question. Because we receive no fees from third parties as a result of our recommendations, no ERISA-defined prohibited transactions occur.

10. What percentage of your plan clients utilize money managers, investment funds, brokerage services or other service providers from whom you receive fees?

0%. [Name of your firm] accepts no such fees from any money managers, investment funds, brokerage services, or other service providers.

W. Scott Simon is an expert on the Uniform Prudent Investor Act and the Restatement 3rd of Trusts (Prudent Investor Rule). He is the author of two books, one of which, *The Prudent Investor Act: A Guide to Understanding* is the definitive work on modern prudent fiduciary investing.

Simon provides services as a consultant and expert witness on fiduciary issues in litigation and arbitrations. He is a member of the State Bar of California, a Certified Financial Planner® and an Accredited Investment Fiduciary Auditor™. Simon's certification as an AIFA™ qualifies him to conduct independent fiduciary reviews for those concerned about their responsibilities investing the assets of endowments and foundations, ERISA retirement plans, private family trusts, public employee retirement plans as well as high net worth individuals.

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